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Director- Crypto Policy Unit

Financial Systems Division

The Treasury

Langton Crescent

PARKES ACT 2600

By email; [crypto@treasury.gov.au](mailto:crypto@treasury.gov.au)

Dear Director

**Australian Custodial Services Association Submission on Token Mapping Consultation February 2023:**

The Australian Custodial Services Association (ACSA) is the peak industry body representing members of Australia's custodial and investment administration sector. Our mission is to promote efficiency and international best practice for members, our clients, and the market. Members of ACSA include NAB Asset Servicing, J.P. Morgan, HSBC, State Street, BNP Paribas Securities Services, BNY Mellon, Citi, Clearstream and The Northern Trust Company.

Collectively, the members of ACSA hold securities and investments in excess of AUD \$4.3 trillion<sup>1</sup> in value in custody and under administration for Australian clients comprising institutional investors such as the trustees of major industry, retail and corporate superannuation fund, life insurance companies and responsible entities and trustees of wholesale and retail investment funds. ACSA member services are therefore integral to supporting the investment and retirement savings of a large part of the Australian population.

A key priority for ACSA is ensuring that future regulation allows for efficient and effective market operations that ensure adequate investor protection, particularly for institutional and wholesale investors.

ACSA has formed an industry taskforce made up of ACSA members with local and global experience relating to crypto assets licensing and custody which enables ACSA to provide consultation input to Token Mapping as a precursor to effective regulation in that space.

*DETAILS FOR SUBMISSION*

ACSA believes regulations and laws should look through the technology underpinning new digital and crypto assets. Where crypto assets generate the same risk & outcomes, then they should be treated similarly to comparable traditional financial products, with similar licensing, disclosure, and other regulatory requirements.

To the extent entities provide a service in respect of a crypto assets which meet the definition of financial products, they should comply with the existing relevant Australian Financial Licensing regimes including for issuers, exchanges and custodians.

ACSA's position is that the AFSL regime can be the appropriate licensing regime for custodians providing crypto asset custody services. ACSA believes Treasury should consider authorising crypto assets as a subset of products to those holding existing financial service licenses (such as the product authorisation for carbon emission units)

While there is no one standard for taxonomy ACSA support a principle of global harmonisation of the classification taxonomy for crypto assets. Further, greater reference to global regulatory frameworks is encouraged. As best as possible token mapping and regulation should be globally consistent and avoid novel or Australian specific taxonomy and regulation.

ACSA believes crypto asset categorisation should be based on the nature of and unique characteristics of a particular crypto asset. There could be unintended consequences from a broad catch all definition of crypto assets and therefore guidance on exclusions or tests may be required.

Financial instruments e.g., digital native security that would otherwise be captured as "financial products" should be regulated as traditional securities.

Asset related tokens or wrapped tokens which reflect an underlying asset should be similarly regulated. Where a regime already applies to the underlying product or asset should apply as far as practical.

There are several asset types that could meet crypto assets that ACSA believes should be excluded from the definition of crypto assets:

- Derivatives products where they may be issued for both financial and crypto assets but be regulated from primary derivatives regulation.
- Tokens that are used solely for the internal bookkeeping records of a financial institution should be excluded.
- Non-fungible tokens (NFTs) which proxy unique assets or digital collectibles should be excluded.

ACSA supports categorisation as essential to regulatory clarity and further advancement of regulatory regimes. ACSA encourages reference to global standards being developed in other jurisdictions to avoid any bespoke Australian treatment. A summary of select global regulations covering crypto assets are included at the end of this submission.

Yours Sincerely

## A.BACKGROUND

Q1) What do you think the role of Government should be in the regulation of the crypto ecosystem?

ACSA supports the Governments policy objectives for defining and regulating crypto assets, ecosystems and service providers. Legal and regulatory certainty is critically important for institutional investors and service providers to enable market confidence and deliver appropriate foundations for consumer protection.

Its is appropriate for the Government to set rules to ensure market fairness, establish standards to ensure safety and quality of products and assure financial systems stability.

The regulatory approach should seek to 'look through' the technology and apply regulation consistently, based on the risks associated with the product.

The Government should regulate the crypto ecosystem ensuring equal footing (Regulatory Equivalence) with analogous traditional financial products. Regulations should address the underlying activity, not the technology supporting the activity. Otherwise, uneven regulation risks the creation of regulatory arbitrage where certain activities are either less regulated due to the technology that supports them, thereby hurting consumers and the financial ecosystem, or certain technologies are unfairly regulated, thereby hurting innovation.

As an example, an algorithmic stablecoin backed by a basket of reserve assets should be regulated as the analogous financial product --a money market fund, with proper registration, disclosures, and licenced investment managers. Consumers of algorithmic stablecoins should receive the same protections as investors in money market funds, and dangerous investments shouldn't be allowed simply because they're offered via new technology. In the same light, a token that serves as a bank's internal book entry of a customer's deposit on the bank's private, permissioned, and closed, blockchain system, should not be subject to additional regulation, outside of the bank regulator's normal regulatory supervision of any other books and records system of a bank. Otherwise, imposing stablecoin regulatory obligations on the internal books and records systems may stifle the adoption of new technology.

Governments need to develop policies to better protect institutions in asset ecosystem from fraud and other risks associated with the "bad actors" in the market. In the instance of institutional investors having FTX exposure, clearer guidelines should be in place to allow them to seek restitution to avoid having to write off these assets.

Regulatory frameworks for licensing for exchanges and service providers should follow crypto asset categorisation.

Q2) What are your views on potential safeguards for consumers and investors?

For tokens that are financial products, ACSA encourages a consistent regulatory approach to risk disclosure and consumer protections. ACSA does not support duplicative regulatory frameworks. ACSA believes Treasury should consider authorising crypto assets as a subset of products to those holding existing financial service licenses (such as the product authorisation for carbon emission units).

## B. TOKEN MAPPING; TERMINOLOGY AND CONCEPTS

Q3) Scams can be difficult for some consumers to identify.

- a) Are there solutions (e.g. disclosure, code auditing or other requirements) that could be applied to safeguard consumers that choose to use crypto assets?

Not answered.

- b) What policy or regulatory levers could be used to ensure crypto token exchanges do not offer scam tokens or more broadly, prevent consumers from being exposed to scams involving crypto assets?

Not answered.

Q4) The concept of 'exclusive use or control' of public data is a key distinguishing feature between crypto tokens/crypto networks and other data records.

- a) How do you think the concepts could be used in a general definition of crypto token and crypto network for the purposes of future legislation?

ACSA supports the policy position that if a token, falls within the functional perimeter of a financial product, then the asset falls within the existing financial services regulatory framework,

If a token has a clear non-financial function (tokens used for provenance, identity, record keeping, data storage or ticketing) they should not be defined as financial assets or fall within the realms of Government Policy on tokens.

The Law Commission (UK) consultation paper in 2022 referenced the term "exclusive use or control" of the crypto token and it is a technically sound concept in establishing property rights. This as a way of associating the token asset, disassociated from the network/hardware where the asset is recorded.

The simplistic view is that who owns the private keys is the and rightful owner of the digital assets and has rights to "use and control" as noted in the consultation paper.

ACSA would also consider how Institutional Custodian concepts would apply with regard to "use & control" for e.g. Concepts of Nominee holdings and assets held in Trust.

Further clarity might also be required in situations where there is an insolvency event, for e.g., in the FTX episode, even if the transaction is completed and the BTC sits within the institution's wallet (on FTX), the institutional investor seemingly had "use and control rights" but in the situation of liquidation, they still cannot lay claim to the BTC as they do not hold the keys.

Further disadvantage of adopting “exclusive use or control” includes enforcement: In the case of fraud, the institutional investors almost have no means to seek restitution, as the hacker now have “exclusive use and control” over the stolen assets.

- b) What are the benefits and disadvantages of adopting this approach to define crypto tokens and crypto networks?

As above

Q5) This paper sets out some reasons for why a bespoke ‘crypto asset’ taxonomy may have minimal regulatory value.

- a) What are additional supporting reasons or alternative views on the value of a bespoke taxonomy?

ACSA supports the policy position that if a token, falls within the functional perimeter of a financial product, then the asset falls within the existing financial services regulatory framework, and would not support duplicative or divergent policy. This includes classifications of analogous intermediaries and service providers.

Should assets fall outside of financial products, then a common taxonomy and treatment could ensure a consistent industry approach, appropriate regulatory frameworks and investor protections.

However, ACSA encourages a consistent global approach to taxonomy outside of financial products. ACSA references the recent Global Financial Markets Association (GFMA) submission on International Regulation for Crypto Assets to the Financial Stability Board<sup>ii</sup>. "It is important that global standard setting bodies to promote the coordination of an effective and aligned global regulatory framework.

Uniformity will help fill unintended gaps to prevent market failures we have recently seen in centralized exchanges and lenders.

ACSA supports the principals that same risk should generate the same regulatory outcomes. Technological neutrality should ensure and or avoid need to reference to network, protocols and other cryptographic features of tokens.

- b) What are your views on the creation of a standalone regulatory framework that relies on a bespoke taxonomy?

ACSA supports the policy position that if a token, falls within the functional perimeter of a financial product, then the asset falls within the existing financial services regulatory framework, and would not support duplicative or divergent policy. This includes classifications of analogous intermediaries and service providers.

In most cases financial assets or tokens that have the same activity and risk as financial assets can find analogous regulatory and licensing categorisation for activities such as trading what may or may not be

facilitated by intermediaries or service providers and the infrastructure or platforms that underpin the assets and activities such as exchanges.

ACSA Agrees that with the pace of innovation and change it may be too complex to create a bespoke taxonomy as too broad the universe of functions and networks.

- c) In the absence of a bespoke taxonomy, what are your views on how to provide regulatory certainty to individuals and businesses using crypto networks and crypto assets in a non-financial manner?

The use of crypto assets should not be conflated with the use of distributed ledger technology (DLT) or blockchain infrastructure for existing, regulated financial services and processes. This **technology neutral approach** would support this use of the DLT or blockchain falling under the existing appropriate risk management framework. Regulated financial institutions and the broader financial services industry have for some time recognized that DLT is a secure method of recordkeeping. The benefits of DLT and blockchain infrastructure extend to the internal recordkeeping function of regulated financial institutions, many of which have spent considerable resources to implement solutions that drive efficiencies and reduce risk. As such, if adopted broadly, DLT, blockchain infrastructure and other similar technological innovations have the potential to materially strengthen the resilience of the financial system. Accordingly, we recommend that the Treasury's proposals avoid supporting regulation that would limit the design option for regulated financial institutions' internal books and records systems.

In this vein, the definition of crypto asset should **exclude tokens that are used solely for the internal bookkeeping records of a financial institution ("Book Entry Tokens")**. Book Entry Tokens cannot be transferred outside of a closed internal network of one or a select number of financial institutions. These include applications such as deposit tokens issued by banks to reflect deposits in their accounts. Book Entry Tokens should be viewed as a method of (and equivalent to) book entries for financial institution systems that happen to be designed using an internal blockchain in lieu of a more traditional structure. Requiring licensing of Book Entry Tokens would restrict innovation and development of more efficient internal systems. Such internal systems are already subject to regulatory review and oversight as part of the normal supervisory process of such financial institutions.

Other exclusions could also include Asset related tokens which reflect an underlying asset where the regime that already applies to the underlying product, service, or asset should apply as far as practical.

- Financial instruments e.g., digital native security that would otherwise be captured as "financial products" to be regulated as traditional security.
- Derivatives products where they may be issued for both financial and crypto assets but be regulated from primary derivatives regulation.
- Non-fungible tokens (NFTs) which proxy unique assets or digital collectibles should be excluded.

## C. INTERMEDIATED TOKEN SYSTEMS

Q6) Some intermediated crypto assets are ‘backed’ by existing items, goods, or assets. These crypto assets can be broadly described as ‘wrapped’ real world assets.

- a) Are reforms necessary to ensure a wrapped real-world asset gets the same regulatory treatment as that of the asset backing it? Why? What reforms are needed?

Consistent with financial structured products, wrapped real-world assets should follow a consistent framework for regulation.

These include:

(1) Transparency in Disclosure: Issuers of digital assets wrapped in real-world assets should be required to provide clear and transparent information about the assets backing the tokens, including the terms and conditions of redemption. This can help institutional investors to make informed decisions about whether to invest in these assets.

(2) Reserve Requirements: Issuers should be required to maintain a certain percentage of underlying assets as reserves to ensure that they can meet their obligations to redeem the tokens (especially in the case of mass withdrawal).

(3) Usage of a qualified custodian: Issuers should be required to hold the underlying assets with a custodian, which would provide an additional layer of protection for institutional investors including audit and control requirements. Additional controls may need to be considered for e.g., to avoid unauthorized staking and lending.

(4) The reserve assets must be held in a segregated and bankruptcy remote manner that ensures the consumer will always be able to redeem the crypto asset for the reserve asset. This means:

- The reserve assets are held solely for the benefit of the investor. The creditors of the issuer of the coin, the processor/servicer of the coin, custodian of the reserves, or any other party cannot have claims to the reserve assets in the event of the bankruptcy of any of the foregoing parties. The reserve assets should be segregated from the assets of any third party, in accounts titled for the benefit of the coin holders. The reserve assets may not be used or rehypothecated. For stablecoins pegged 1:1, the reserve assets may only be transferred to the coin holder upon redemption/burn of the coin.
- For 1:1 stablecoins, the reserve assets must be sufficient to cover all minted coins.
- For algorithmic stablecoins, the same management requirements for the analogous financial product (e.g., money market funds) should apply.

- b) Are reforms necessary to ensure issuers of wrapped real-world assets can meet their obligations to redeem the relevant crypto tokens for the underlying good, product, or asset?

Yes, as above and noting bankruptcy/insolvency remoteness in 6(a) above.

Q7) It can be difficult to identify the arrangements that constitute an intermediated token system.

- a) Should crypto asset service providers be required to ensure their users are able to access information that allows them to identify arrangements underpinning crypto tokens? How might this be achieved?

ACSA supports the policy position that if a token, falls within the functional perimeter of a financial product, then the asset falls within the existing financial services regulatory framework, and would not support duplicative or divergent policy including for information and disclosure.

- b) What are some other initiatives that crypto asset service providers could take to promote good consumer outcomes?

No answer provided.

Q8) In addition to the functional perimeter, the *Corporations Act* lists specific products that are financial products. The inclusion of specific financial products is intended to both: (i) provide guidance on the functional perimeter; (ii) add products that do not fall within the general financial functions.

- a) Are there any kinds of intermediated crypto assets that ought to be specifically defined as financial products? Why?

As a general principal the risks and outcomes should be considered as per the definition of a financial product.

- b) Are there any kinds of crypto asset services that ought to be specifically defined as financial products? Why?

ACSA considered this a complex question, were clear distinction needs to be made between a financial product and or service. It is an area that requires careful drafting and comparison to existing regulated components of our financial system. For example, services akin to our current financial systems including fund managers, investment advisors, custodial banks, market maker and Exchanges.

It is recognised that fundamentally need this foundation before can get the outcome for market and services regulation like custody.

Q9) Some regulatory frameworks in other jurisdictions have placed restrictions on the issuance of intermediated crypto assets to specific public crypto networks. What (if any) are appropriate



measures for assessing the suitability of a specific public crypto network to host wrapped real world assets?

Financial Products should be assessed based on same risks, same outcomes, same regulation including restrictions. This should remain technology neutral. A public network need not be the driver of restrictions for financial products whether intermediated or not.

Both public and private permissioned networks should be assessed for security and reliability and where necessary be disclosed.

A public network should have a strong track record of security and be resistant to hacking or other malicious attacks. These are often established through published and transparent cryptographic and consensus protocols.

The governance structure of the network should be transparent and well-defined, with clear rules for resiliency as well as decision-making and dispute resolution. This can help to ensure that issues can be resolved quickly and efficiently. For example, when a fork happens

In addition, functionality provided by the chain. We should be looking for public crypto network that has a robust set of smart contracts to support the trading and settlement of these assets.

Q10) Intermediated crypto assets involve crypto tokens linked to intangible property or other arrangements. Should there be limits, restrictions or frictions on the investment by consumers in relation to any arrangements not covered already by the financial services framework? Why?

Consistent with financial structured products, wrapped real-world assets should follow a consistent framework for regulation. To the extent that a crypto asset represents an underlying real word asset, then provided it doesn't meet the definition of a financial product, it should be excluded from the financial services framework. For institutional investors, they can manage their own risk of assessing investment in nonfinancial assets.

Non-financial assets will still fall or need to fall within common law concepts such as rights of ownership and rights including intellectual property or consideration of collectibles.

## PUBLIC TOKEN SYSTEMS

Q11) Some jurisdictions have implemented regulatory frameworks that address the marketing and promotion of products within the crypto ecosystem (including network tokens and public smart contracts). Would a similar solution be suitable for Australia? If so, how might this be implemented?

Marketing & promotion restrictions should apply consistently with all crypto assets, network tokens or smart contracts, that meet the definition of a financial products.

Q12) Smart contracts are commonly developed as 'free open-source software'. They are often published and republished by entities other than their original authors.

- a) What are the regulatory and policy levers available to encourage the development of smart contracts that comply with existing regulatory frameworks?

Looking through the technology of smart contracts, product performance and functional performance of a product and or service can still be supported by regulatory frameworks.

Regulated financial service providers have existing standards with regards to risk assessment and mitigation including technology implementation risk, model risk and compliance risk.

Over time with the development of regulatory frameworks increasingly asset issuers and investors will tend towards risk protections and working within regulated frameworks. Smart contracts create the opportunity for regulatory compliance to be self governing. Smart contracts could be audited to have in built compliance by design enabling regulators to bring regulation into the pre-trade/preservice era rather than being post trade and post performance reported.

While some constructs may not have traditional analogies, over time guidance will be required to refine requirements and manage risks. Clear caution is required to ensure there is not overreach into what would not be considered a regulated service including administration or valuation and reporting activities.

Co-ordination mechanisms are a spectrum and can be difficult to establish extent of "intermediation" and may not fit within regulated frameworks.

Decentralised finance sits in this mechanism. Though traditional providers may be operating in this space. e.g, Soc Gen Crypto backed home loans it may be that for the immediate time it will not be possible to create a regulatory framework that captures the full spectrum of crypto assets.

- b) What are the regulatory and policy levers available to ensure smart contract *applications* comply with existing regulatory frameworks?

As above

Q13) Some smart contract applications assist users to connect to smart contracts that implement a pawn-broker style of collateralised lending (i.e. only recourse in the event of default is the collateral).

- a) What are the key risk differences between smart-contract and conventional pawn-broker lending?

Not Answered

- b) Is there quantifiable data on the consumer outcomes in conventional pawn-broker lending compared with user outcomes for analogous services provided through smart contract applications?

Q14) Some smart contract applications assist users to connect to automated market makers (AMM).

- a) What are the key differences in risk between using an AMM and using the services of a crypto asset exchange?

Not Answered

- b) Is there quantifiable data on consumer outcomes in trading on conventional crypto asset exchanges compared with user outcomes in trading on AMMs?

Not Answered

## ACSA Summary of select Global Regulations

### North America

In March 2022 the US Administration issued an Executive Order on ensuring responsible development of Digital Assets, outlining an approach to address risks of digital assets covering consumer and investor protection, financial stability, illicit finance, US leadership in the global financial system and economic competitiveness, financial inclusion and responsible innovation. The timeline of mandated actions in the executive order runs to October 2022, with the initial report due in September 2022.

### Singapore

The Monetary Authority of Singapore (“MAS”) launched a multi-year collaborative project to explore and test Blockchain and DLT. The project covers interbank settlement, domestic and cross border payments, enhanced DvP and the issuance of tokenised assets across several asset classes. SGX have partnered with Temasek to launch a joint venture to expedite the issuance of tokenised fixed income.

### HK/China

In 2020 the Securities & Futures Commission (“SFC”) licensed its first Virtual Assets trading platform. The Monetary Authority issued new guidance in January 2022 with a framework for financial institutions to undertake activities related to virtual assets to ensure investor protection regimes are maintained and to expedite the distribution, dealing and advisory services in virtual assets. The licensing regime will take effect in March 2023.

### UK

The UK Government has launched the UK Digital Strategy focussed on Digital Foundations, Ideas and Intellectual Property, Skills and Talent, Financing Digital Growth, Spreading Prosperity and Enhancing the UK’s place at the centre of innovation. Stablecoins to be brought within regulation paving their way for use in the UK as a recognised form of payment.

Announcement part of a series of measures to make the UK a global hub for digital asset technology and investment.

Measures include legislating for a ‘financial market infrastructure sandbox’ to help firms innovate, an FCA-led ‘CryptoSprint’, working with the Royal Mint on an NFT, and an engagement group to work more closely with industry

### EU

The EU have produced a significant legislative paper to create a framework that enables the tokenisation of traditional financial assets and the wider use of DLT in financial services.

On 2 June 2022, the [Distributed Ledger Technology \(DLT\) Pilot Regime Regulation](#) was published in the EU Official Journal. It entered into force on 23 June 2022 and will apply from 23 March 2023. The pilot regime lays down the conditions for acquiring permission to operate a DLT market infrastructure.

## Germany

The German Electronic Securities Act (Gesetz zur Einführung elektronischer Wertpapiere “eWpG”) entered into force in the summer of 2021. Enabling the electronic issuance of bearer bonds, mortgage bonds and certain fund units. Issuers can now decide whether to issue securities in the form of a certificate or electronically. On 18 June 2022, the new [regulation](#) on crypto fund shares (Verordnung über Kryptofondsanteile – KryptoFAV) entered into force. It introduces the possibility to issue fund shares of investment funds on a DLT in addition to the possibility to issue fund shares with a global certificate. Fund shares can be partly tokenised, even within an existing share class.

## Switzerland

In 2020 the Swiss parliament approved the DLT act, a framework including amendments to federal laws aligning DLT rights for the tokenisation of assets. Six Digital Exchange have issued new tokenised securities, available to licensed participants and retail investors only via DLT, providing increased efficiency, liquidity, accessibility and decreased capital requirements

## Luxembourg

The Luxembourg Stock Exchange has allowed security tokens to be registered onto the Securities Official List (“SOL”), a section of LuxSE’s Official List from January 2022. However, LuxSE has not permitted the trading of security tokens. The idea behind the registration is to “enhance visibility to issuers of DLT financial instruments and to the security tokens”

Also in January 2022, the CSSF published a white paper on DLT, detailing practical steps for regulated entities who want to use DLT.

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<sup>i</sup> Reference to December 2022 ACSA Publication <https://acsa.com.au/news/631710/>

<sup>ii</sup> <https://www.gfma.org/wp-content/uploads/2022/12/gfma-response-to-fsb-crypto-asset-consult-15-december-2022.pdf>